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CENTRAL INTELLIGENCE GROUP

THE INTERNATIONAL
ECONOMIC POSITION OF THE
UNITED KINGDOM

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31 May 1947

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THE INTERNATIONAL ECONOMIC
POSITION OF THE UNITED KINGDOM *

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SUMMARY

For more than a century the people of the British Isles have imported annually from the rest of the world more commodities than they have exported. Imports have contributed greatly to British standards of living and have provided many of the essential raw materials for the notable and expanding industrial activity in that country during this period. This commodity trade deficit was financed from current returns on foreign investments, returns from shipping and receipts for financial, insurance and other commercial services. Up to the time of the First World War the returns from such investments and services were adequate not only to meet the deficit in commodity trade but to provide in most years a balance for further foreign investment throughout the world by British agencies. During the century preceding the First World War, Great Britain was the leading international trading country in the world, the greatest creditor, and continued to increase its foreign investment position.

During the decade following the Treaty of Versailles, economic activity between the United Kingdom and other countries of the world appeared, on the surface, to be similar in many respects to that which preceded the War. The British continued to receive substantial returns from investments, shipping and commercial services. Net receipts on current account, however, were substantially smaller than in the pre-war years and Britain's capacity to extend credits to foreign borrowers was substantially curtailed. After 1930 the United Kingdom experienced a net credit in current international payments in only one year, 1938. In general terms, therefore, it is now clear that the First World War ended the period of active expansion in Britain's creditor position.

The economic adjustments imposed by the circumstances in which the people of the United Kingdom now find themselves following their tremendous exertions during a long and devastating war include both internal and international effects. Internal affairs are referred to in this report only briefly in their relation to the international situation. Some of the principal international effects of economic changes in the United Kingdom in recent years, particularly those of concern to the United States, are summarized below:

1. The United Kingdom no longer will serve as the steadying influence upon world trade and finance to the extent that it has for a century or more.

* This report has the concurrence of the intelligence agencies of the War and Navy Departments and of the Army Air Forces. A statement of dissent by the Department of State is contained in Enclosure "B" hereto.

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a. Although the British will continue to import heavily, it will be necessary for them to be much more selective and to give special preference to particular commodities which are vital to their economic life, such as certain foods and raw materials for industry. Consequently they can no longer serve as a safety overflow reservoir for world export trade, ready to accept for their own consumption or for subsequent re-sale to others very large quantities of goods when obtainable at the right price.

b. Although the United Kingdom will continue a very substantial short-term international banking business, it can no longer, now or in the foreseeable future, serve as the great international creditor of the world.

c. In view of the necessity for the United Kingdom, as well as nearly all other large commercial countries of the world, to expand exports to survive, the state of the world's economic health now depends as never before upon the commercial and financial policies and the internal economic conditions in the world's creditor countries, particularly the United States.

2. For a decade or more the United Kingdom will experience a shortage of long-term foreign funds, and probably will exhaust the present United States and Canadian lines of credit prior to the year 1952 which was expected to mark the end of the post-war readjustment period. It is not believed, however, that the British will find it desirable to seek any further direct loans from the United States Government. They will be more likely to seek recourse first to a number of other measures such as the following: severe limitation of unessential imports, negotiation of a relaxation in the convertibility provision of the United States loan agreement, withholding the release of accumulated sterling balances, a rehabilitation loan from the International Bank for Reconstruction and Development, drawing upon their credit with the International Monetary Fund, and loans and investments from private overseas sources. Even after they have exhausted the above possibilities the magnitude of their financial need may force the British to turn to the United States Government for further assistance perhaps within a program of economic aid to Europe as a whole.

In view of the shortage of foreign funds which the United Kingdom is likely to experience for several decades the prospects that it will be able to meet in full the interest and debt retirement provision of its foreign obligations are not good. By 1952 the British net overseas assets may be in the order of £1-3/4 billion (gold, dollar exchange, net investments) and corresponding

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net overseas liabilities some £3-3/4 billion (United States and Canadian loans, £1½ billion; loans funded from sterling balances, £2 billion; other loans, £½ billion). After 1952 the United Kingdom will probably have annual obligations on capital account of the order of £100 million. There is no early prospect that Britain's credit balance on current account will equal that amount.

3. The withdrawal of British control over large areas in the Middle East and sovereignty over India together with other changes in this area in recent years are not solely political in character but also have important economic consequences. Strong nationalistic trends which are already evident are likely to result in the imposition of restrictions upon trade designed, particularly in India and Egypt, to enhance the economic self-sufficiency of the countries concerned. Several of the countries in this area which have been under British control or influence are already endeavoring to free themselves from currency and other financial ties to the pound sterling and to the British Treasury. The international financial position of India, Iraq, and Egypt is much stronger when compared to other countries of the world than it was before the War. This is due, in varying degrees in different countries, to such influences as the war-time accumulation of sterling balances, the recent reductions in indebtedness to foreigners and, in some cases, current balances of receipts over payments in commodity trade. The international trade of these countries in the future is likely to be determined largely upon a basis of national economic policies and competitive international prices and to be relatively freer from British governmental and private influences. The above comments do not reflect the possibility of unrest in the Middle East or continued civil disorder in India which would have far-reaching adverse repercussions upon the internal economic stability in these parts of the world and consequently upon international economic relations with them.

4. Although handicapped by a shortage of capital, the United Kingdom is likely to emphasize increasingly the development of Africa, particularly the increased utilization of mineral and other resources. The improvement of military defenses in the British possessions in that continent, however, will probably be deferred in part for lack of funds.

5. The capacity of the United Kingdom to provide the manpower and supplies for large military forces will be greatly curtailed for many years to come by the sharp contraction of British claims upon resources in other parts of the world (both through loss of investments and sovereignty), by the severe war-time destruction and deterioration of capital facilities in the British Isles, and by increased British dependence for survival upon exports and thus upon domestic production. Consequently,

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Britain will be much more vulnerable economically in times of war and less capable of resisting economic pressures in times of peace than ever before. For the immediate future the British are under great pressure to curtail heavily or abandon completely, political and military operations which require large sums in foreign exchange or the extensive use of British resources.

An evaluation of further changes in the economic position of the United Kingdom must clearly reflect not only economic factors but also the strength of British political institutions and the character of the British people. The cold basic facts of the economic situation have only recently been made known to them. The British are discovering that they are confronted with one of the most trying economic periods of their long history. Continued shortages of food, shelter, and other essentials for comfortable living, combined with the necessity for greater dependence upon sweat and hard labor and less upon returns from overseas investments and services even to pay for a reduced level of imports, will aggravate the social and political stress resulting from the War. Britain will be poorer and the area of British influence much smaller. The British will be increasingly aware of the limitations in their own resources, manpower, and financial capabilities and probably will depend more upon others for leadership. Few people, however, have the pragmatic sense of adjustment to practical situations, the toughness and sturdiness in adversity, and the capacity for self-discipline in the common interest possessed by the British. It is consequently believed that the British, in time, will make a successful, even though grudging, adjustment, along the lines indicated in this report, to the straitened conditions in which they now find themselves. However, the capacity of the British people to support the austerity program has its limits -- if pressed too far, they may react politically in a manner which will delay the present economic recovery program.

A brief analysis of the international economic position of the United Kingdom, discussed under the following headings, is contained in the Enclosure hereto:

International Investments

International Balance of Payments

Brief Evaluation of the International Financial Position

Sterling Balances

British Government Expenditures Overseas

The Dollar Problem.

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POSITION OF THE UNITED KINGDOM

Two measures of the international economic position of the United Kingdom are referred to in this brief evaluation:

- a. The foreign investment position in terms of long-term loans and investments and short-term sterling balances.
- b. The annual balance of international payments.

International Investments

British overseas investments, as already indicated, increased rapidly from the time of the Napoleonic Wars until the First World War. Illustrative figures for British net foreign investments during this period are as follows: 1854, £600 million; 1895, £1,600 million; 1913, £3,650 million. Recent changes in the status of British international investments and short-term obligations are shown in Appendix "A". As may be observed from that table, the total for net overseas investments in 1939 (£3,500 million) was not greatly different (actually slightly less) than that twenty-six years before, immediately prior to the First World War.

The net overseas assets and liabilities shown for 30 June 1946 are the latest consolidated figures available. Since that time several developments such as the following have occurred which change both the assets and liabilities totals:

- a. Repatriation of United Kingdom investments in Argentina in settlement of sterling balances in the amount of £150 million. (Reduces both assets and liabilities equally.)
- b. Drawings on the \$3.75 billion United States line of credit (sterling equivalent approximately £487 million to date, 31 May 1947).
- c. Drawings on the \$1.25 billion Canadian line of credit (sterling equivalent about £160 million to date).
- d. Changes in net demand obligations. During 1946, sterling balances were drawn upon heavily by some countries, especially by India, but in the aggregate these obligations increased approximately £70 million during that year.

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- e. Very substantial increases in gold reserves.
- f. In March 1947 the Australian and New Zealand governments announced gifts to the United Kingdom in the amounts of £25 million and £10 million respectively. This generous action must be exceedingly welcome to the British government but in magnitude is less than 15 percent of the balances held by these two Dominions and is only a fraction of the total sterling balances held by all countries.

The combined result of these developments will probably yield a figure for net liabilities in excess of £1.5 billion as of 31 May 1947. The United Kingdom, which entered the War with net assets of over £3½ billion, thus has experienced foreign disinvestment from 1939 to date of more than £5 billion in addition to heavy wartime domestic losses on housing, factories, and other internal capital facilities.

International Balance of Payments

The international balance of payments figures for the United Kingdom for selected years, as shown in Appendix "B", furnish the most inclusive measure of its year-to-year international economic activity.

The year 1913 illustrates the international economic position of the United Kingdom on current account during its height as a creditor power. The net credit balance of international receipts over payments on current account, £194 million (available for foreign investment or similar purposes), in that year was only slightly more than the corresponding figures for most of the years during the previous decade.

The year 1924 is representative of the decade immediately following the First World War. The net credit balance in that year, £72 million, was less than half of the corresponding figures for most of the years immediately preceding the War, even though commodity trade in monetary terms was much larger, approximately twice that in 1913. The figure for the year 1938, a net debit of £70 million, illustrates the conditions prevailing during the disturbed decade immediately preceding the Second World War.

The estimates for 1946, the first full year following the cessation of hostilities, disclose some of the significant changes that have taken place in Britain's economic relations with the rest of the world in recent years. The aggregate net deficit on current account for 1946 is £400 million, comparable with a net credit of £72 million in 1924. This far-reaching change is not attributable to changes in net commodity trade since the figures for this item are almost identical for the two years. Rather, the change reflects two other factors: a large decline in net investment income (from £220 million in 1924 to £80 million in 1946) and a

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tremendous increase in overseas governmental expenditures (civil and military occupation costs, aid to liberated countries, etc.).

The figures shown in Appendix "B" for the years 1947, 1948, and 1952 are considered conjectures based upon discussions with a number of US Government experts and statements by responsible British government and private sources. The principal assumed trends in the figures covering this six-year period* are:

- a. Substantial increases in British exports. The announced goal to expand the physical volume of the United Kingdom exports to 175 percent of that in 1938 is an ambitious objective which is not likely to be fully attained during the next two or three years for the following reasons, although it is assumed that the goal will be attained by 1951 or 1952:
 - (1) The allocation of labor and resources to the production of internal capital (housing, industrial plants and equipment and public facilities to replace war-time losses both from enemy action and rapid depreciation) will probably represent a larger claim on current production than appears to be recognized at present. Under the stresses of the past winter, for example, the state of disrepair of the railroads and other facilities has proven much greater than had been anticipated.
 - (2) It is not likely that the necessary modernization of industrial processes and the development of new products will be fully realized. Some successful technological progress undoubtedly will be attained. But the conservative habits, scarcity of capital, diminishing returns in the exploitation of coal, agriculture, and other domestic resources, and inexperience in the planned control of socialized industry will retard the prompt accomplishment of the necessary changes.
- b. Continued restriction of British imports (official 1947 goal is 80 to 85 percent of 1938 volume, ultimate goal is 110 percent of 1938 volume). Even if realized, the provisions in the British plans for an increase in exports to 175 percent of the 1938 volume, coincident with an increase in imports to 110 percent of the 1938 volume, yields little prospect for improvement in the austere living standards of the British public, particularly when it is realized that

* See page 10 for additional assumptions regarding sterling balances.

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from 20 to 30 percent of the imports are not for consumption but are the materials required to produce exports. After adjustment for price changes, consumer expenditures in 1946 compared to those in 1938 show: food, 2 percent decrease; durable household goods, 20 percent decrease; clothing, 26 percent decrease; books and magazines, 37 percent increase; tobacco, 33 percent increase; and entertainment, 59 percent increase. The imports of the latter two items, however, cannot be sustained and they are likely to decrease in the very near future.

- c. Substantial decline in prices. The British balance of payments has been adversely affected in recent years by a more rapid increase in import than in export prices, and by the absolute increase in all commodity prices relative to rates of return upon investment, shipping, and other intangible payments. Thus, a general downward trend in prices will tend to improve the British balance of payments. It appears likely that there will be a general decrease in prices of considerable magnitude during the next few years. It has been assumed that there will be a decline in general prices from those prevailing in 1947 of about one-sixth in 1948 and about one-third in 1952. It also appears likely that prices of United Kingdom imports, particularly raw materials and foodstuffs, will during the next few years decline more rapidly than the prices of United Kingdom exports.
- d. Slight further decreases in income from overseas investments (resulting from probable further repatriation of present British holdings of foreign investments).
- e. Very sharp reduction in occupational and other government expenditures overseas from some £300 million in 1946 to an amount in the order of £50 million in 1952. (The latter figure is manifestly highly conjectural but is supported by some statistics and by available information on British military and economic policy.)

The year 1952 (data shown in Appendix "B") was selected because it is the first year following the assumption of repayment on the recent dollar loan as provided in the Anglo-American loan agreement. For that year it is believed that current international transactions may yield a credit in the order of £55 million, from which must be deducted £25 million for interest on the United States and Canadian loans. This leaves a prospective net credit balance in the order of £30 million for release of sterling balances, long-term debt retirement, and other capital transactions. Contractual obligations for debt retirement, together with release of sterling balances, will be in excess of that amount (possibly £75 million annually). Consequently, by 1952 the United Kingdom may be

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able to attain a net credit position on current account but probably will not be able to meet its debt obligations in full at any time in the foreseeable future.

Brief Evaluation of the International Financial Position

For the first time in modern history the United Kingdom is thus no longer a creditor country. In very rough terms it may be said that the First World War marked the close of active expansion in Britain's creditor position. The Second World War has made it a net debtor. To be sure, net income from foreign investments still appears as a credit in Appendix "B". This is due to the fact that Britain's investments overseas yield higher rates of return than do its principal indebtedness, viz. the short-term balances. In 1946, the combined net earnings from all foreign investments and for special interest payments on short-term balances, left a credit of some £80 million. This credit is less than half of the corresponding amount which the United Kingdom received from overseas investments for several decades prior to 1940. Moreover, it is likely to decrease further because of the repatriation of British holdings of foreign investments, the funding of the sterling balances into interest-bearing obligations, and, after 1952, because of interest on dollar loans. Consequently the United Kingdom, although enjoying a small net return from overseas investments for the time being, is fundamentally a net debtor today. Its principal present liabilities, the sterling balances, are described more fully in the following section:

Sterling Balances

During the War the United Kingdom incurred large obligations in pounds sterling in connection with the financing of British military production and operations and the purchase of commodities and services for United Kingdom agencies throughout the world. The accumulation of these sterling obligations was particularly heavy by India and Egypt, more than half of the total at the termination of hostilities being held by these two countries. The aggregate held by all countries in June 1945 was slightly over £3 billion as indicated in Appendix "A". Since that time they have increased to approximately £3.5 billion as of December 1946.

During the Anglo-American loan negotiations in the fall of 1945 the United Kingdom representatives assumed that relatively small amounts of these balances would be released for the maintenance of reserves and for current purchases in the United Kingdom, rather larger amounts would be used to repatriate British holdings of foreign investments, approximately half of the total would be funded into long-term obligations bearing no interest, and very large amounts (the British expected over £1 billion particularly from the Indian and Egyptian holdings) would be cancelled by countries holding these balances as their contribution to the prosecution of the War. A British Mission which was in India, Egypt, and Iraq during February and

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March 1947 for the purpose of preliminary negotiations with regard to a settlement of sterling balances, has thus far had little success. The Indian Government which holds by far the largest balances, some £1,200 million, is insisting upon settlement in full. The Indians are seeking the release of some £50 million annually to pay for their expected commodity trade deficit with the United Kingdom, and have proposed a 2 percent interest on all funded balances. The sterling balances thus are proving to be a much more difficult financial obligation than the British Government had expected a year ago.

In evaluating the prospects for the United Kingdom balance of payments for future years (figures shown in Appendix "B") it is gratuitously assumed that:

- a. Some £600 million in sterling balances will be used during the next five years to repatriate long-term investments. (It is believed that this reduction in foreign investments will more than offset any increased rate of return on retained holdings, and that net investment return consequently will decline as shown in Appendix "B".)
- b. Possibly £300 million will be used to purchase British war plants, military installations, and military stores by countries holding sterling obligations.
- c. Substantial balances will be released currently for the next few years, possibly an average of some £70 million annually.
- d. By the year 1952 these balances will be drawn down to about £2,000 million and will require an interest rate of 1 percent.
- e. Much smaller amounts than originally expected will be cancelled by present holders.

British Government Expenditures Overseas

The Second World War also left Great Britain with extensive overseas commitments which introduce a new debit item in the current balances of payments; namely, the foreign exchange to finance the occupation of conquered territory and to support British forces in other parts of the world such as in Greece, Palestine, India, and Burma. This requirement is proving to be much larger than was expected a year ago. Foreign exchange requirements for civil government, military and other occupation expenses overseas in 1946 were £300 million and for 1947 appear to be approximately £200 million. The cost of the British share of emergency relief imports into the Eastern Zones in Germany in 1947 as at present projected, and included above, is in excess of £75 million.

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British governmental expenditures overseas, particularly those which require foreign exchange, are in direct competition with standards of living of the people of the United Kingdom. The British Government will therefore be under heavy pressure to curtail substantially all such political and military activities particularly in areas not under British sovereignty.

The Dollar Problem

The net deficit on current account is particularly large between the United Kingdom and the dollar countries. In this area, commodity trade in 1946 showed a deficit of \$1,380 million (United Kingdom imports of approximately \$1,650 million and United Kingdom exports to the United States and Canada \$270 million). The aggregate net deficit on current account (after allowances for returns on investment and similar items as well as commodity trade) with the dollar countries in that year was more than \$1,100 million.

To be sure, the United Kingdom has experienced an excess of imports over exports in her commodity trade with the United States and Canada for many decades. Present difficulties arise not from the nature of this trade but from the magnitude of the commodity deficit and from Britain's reduced capacity to pay for the import balances. The commodity trade deficit with dollar countries for 1946 of \$1,380 million is approximately twice as large as corresponding figures for pre-war years. At the same time invisible dollar income is much less. The war-time repatriation of over \$800 million in United States securities has reduced paying assets which in former years helped to support the import balance with the United States.* Furthermore, the supply of dollars obtained by the United Kingdom through triangular trade and from returns on investments in other areas is considerably smaller than in pre-war years because of war damage and post-war political instability in areas such as Malaya and India and because of inconvertibility into dollars of foreign exchange receipts for British exports to some countries. In pre-war years, for example, the merchandise trade of Malaya with the United States yielded between \$150 million and \$200 million net annually.

The present dollar deficit is being supplied by drawing upon the United States and Canadian loans. By the time this source of funds is exhausted it will be necessary for the United Kingdom to make substantial adjustments in her foreign trade by one or more of the following devices: increasing exports to the dollar area, reducing imports from the dollar area, or securing dollar exchange through exports or services to other countries which have dollar balances or whose currencies are readily exchangeable for dollars. An increased availability of dollars from multilateral trade is particularly essential if the United Kingdom balance of payments in the aggregate with all countries of the world is to be even as favorable for 1952 as that estimated elsewhere in this report.

* An additional \$500 million in United States securities is now pledged as security for a Reconstruction Finance Corporation loan.

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NET OVERSEAS ASSETS AND
LIABILITIES OF THE UNITED KINGDOM*
(In Millions of Pounds)

August 31, 1939 June 30, 1945 June 30, 1946 Dec. 31, 1946

Assets:

Gold and dollars (net)	605	453	433	642
Investments (net)	est. 3,500	est. 2,382**	est. 2,300**	2,300
Total	4,105	2,835**	2,733**	2,942

Liabilities:

Net demand obligations and "blocked" balances	476	3,052	3,474	3,480
Overseas loans	0	303	471	734
Total	476	3,356	3,945	4,214
Net Assets	3,629	-521**	-1,212**	-1,272**

* Figures for 1939 and 1945 were supplied by the British Mission which came to the United States to negotiate the loan agreement of that year. No other official data are available. Some experts have estimated the net investments to be somewhat higher. The figures shown for 1946 are projections based upon information from other sources, principally the Federal Reserve Board. All figures for each category are net overseas investments.

** This figure takes no account of the unrecorded transfer of securities, the destruction or depletion of overseas property (particularly in Europe and the Far East), and the increase in the value of remaining investments on account of changes in price level, interest rates, and profit prospects

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APPENDIX "B"

31 May 1947

BALANCE OF INTERNATIONAL PAYMENTS ON CURRENT ACCOUNT

UNITED KINGDOM

(MILLIONS OF POUNDS STERLING)

	1913	1924	1938	1946	Prospects Future Years		
					1947	1948	1952
Merchandise Trade:							
Payments for Total General Imports*			-835	-1110	-1425	-1450	
Receipts for Total Exports Including Re-Exports			+533	+ 890	+1100	+1200	
Net Merchandise Trade Balance	- 65	-228	-302	- 220	- 325	- 250	- 50
Net Income From Shipping*	+ 14	+ 30	+ 20	+ 10	+ 35	+ 35	+ 40
Net Income From Long-Term Foreign Investments	+210	+220	+175	+ 105	+ 100	+ 90	+ 90
Net Special Interest Payments on Short-Term Debts and Balances	***	***	***	- 25	- 25	- 25	- 20
Net Commissions, Insurance, Brokerage, etc.*	+ 25	+ 60	+ 35	+ 30	+ 35	+ 40	+ 40
Net Royalties (Largely or Wholly Motion Picture)	***	***	- 7	- 17	- 15	- 10	- 5
Net Tourist Expenditures (and Overseas Airlines)	***	***	- 12	- 10	- 5	0	- 10
Net Government Expenditures Overseas (Civil and Military, Inc. Relief and Occupation Cost.)	***	***	- 16	- 300	- 200	- 100	+ 50
Net Miscellaneous	+ 10	- 10	+ 37	+ 27	+ 10	***	***
Aggregate Net Balance on Current Account	+194	+ 72	- 70	- 400	- 410	- 220	+ 55#

NOTE: All pound sterling figures are in current year prices. (In 1946, index of import prices = 206, and index of export prices = 198, both on 1938 = 100 base.) For purposes of estimation it is gratuitously assumed that there will be a decline in general prices, from present levels, of about 1/6 in 1948 and 1/3 in 1952, and that the terms of trade will be more favorable to the UK in both years than at present.

- indicates payments for merchandise imports, shipping, financial and other services by foreigners for UK agencies and all other "debit" transactions.

+ indicates receipts for merchandise exports, shipping, financial and other services by UK agencies for foreigners and all other "credit" transactions.

* In all years the imports and net merchandise trade balance figures are f.o.b. cost of imports in the country of origin. Similarly, estimates of shipping and of net commissions for insurance, etc., exclude charges for the services of UK shipping and insurance.

*** indicates zero or included with other items.

Under the conditions shown, for this year the UK also would be responsible for an interest payment of £25 million on the US and Canadian loans which would reduce the net long-term interest and the net balance on current account by that amount.

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OF THE DEPARTMENT OF STATE

The Intelligence Organization of the Department of State is unable fully to concur in the findings of this paper, although it is pleased to acknowledge the cooperation of CIG in endeavoring to reach common ground on all issues. The Intelligence Organization of the Department of State dissents from the report on the following principal grounds:

1. It is the opinion of the Intelligence Organization of the Department of State that the basic economic situation of Britain is more serious than is indicated in this estimate. Moreover, the data presented in the body of the study appear to the Department to confirm its judgment. Consequently, the Department is of the opinion that, although there are reasons why the United Kingdom may not consider a request for additional overseas credits "desirable," emphasis must be laid, to a greater degree than is done in this study, upon the factors which make indispensable such credits either directly or as part of a European reconstruction program.

Recourse by Britain to the alternative measures outlined in the Summary and to the suggested "adjustments" in her foreign trade after dollar credits are exhausted will, in the opinion of the Intelligence Organization of the Department of State, prove inadequate. In particular, the Intelligence Organization of the Department wishes to emphasize that on the basis of its own analysis the United Kingdom cannot be expected to overcome, as distinct from postpone, its current difficulties until its general productive efficiency has been appreciably raised. The CIG report does not satisfactorily demonstrate that the United Kingdom is making sufficient allowances for the capital investment necessary to achieve this productive efficiency.

2. The Intelligence Organization of the Department of State is further of the opinion that the alternative course, which CIG suggests the United Kingdom might choose rather than seek recourse to large-scale financial assistance from the US, involves serious consequences to which the CIG report fails to give adequate consideration. For the United Kingdom such a course would result in a further weakening of her international political and economic position, a shift toward a policy of economic nationalism, postponement of vitally needed capital formation, and lower living standards which would cause popular discontent and reduce the will and ability to produce. For the United States, such a program would jeopardize the prospect of British collaboration in, and contribution to, world economic and political reconstruction.

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CIG Comment: The gravity of the present economic position of the United Kingdom is fully recognized and is emphasized at length in the basic paper. The insistence of the Intelligence Organization of the Department of State, however, upon the necessity of large-scale financial aid from the United States as the key to the United Kingdom situation is believed to emphasize unduly that aspect of the problem and to assume too much for the ends which financial aid will accomplish. Britain's capacity in the future to avoid restrictive trade practices, for example, will be aided not so much by continual financing of payments deficits as by the wide acceptance of multilateral trade by other leading trading countries and by large purchases in world markets on the part of creditor countries. The importance of modernization of selected British industries, not wholesale but carefully chosen in the light of declining British natural resources and limited labor supply, is, of course, unquestionable. The principal conclusions of the basic paper are that several fundamental and probably permanent changes have taken place in recent years in the international economic position of the United Kingdom. It is believed incorrect to imply, as is done in the above dissent, that financial aid from the United States will enable the United Kingdom to escape the fundamental impact of most of these changes.

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